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The Work of the Investment Banker
in the Distribution of Bonds

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THE WORK OF THE INVESTMENT BANKER IN THE
DISTRIBUTION OF BONDS

BY

DELBERT GEORGE GIRTON

THESIS

FOR THE

DEGREE OF BACHELOR OF ARTS

IN BUSINESS ADMINISTRATION

IN THE

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Delbert George Girtou

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TABLE OF CONTENTS.

| | Page |
|--|------|
| Chapter I. Introductory | 1 |
| Chapter II. Evolution, importance and a general view of the bond business | 3 |
| Chapter III. General Principles of Bonds | 9 |
| Chapter IV. Investors and Institutions as Buyers of Bonds | 18 |
| Chapter V. Wholesalers & Wholesaling | 22 |
| Chapter VI. Syndicating and Underwriting | 26 |
| Chapter VII. Bond Exchanges and Transactions | 33 |
| Chapter VIII. Retail Bond Houses | 38 |
| Chapter IX. The Organization of a Bond House | 42 |
| Chapter X. The Relations of House and Investor | 57 |
| Chapter XI. The Foreign Market | 65 |
| Chapter XII. The Future of the Situation | 69 |



THE WORK OF THE INVESTMENT BANKER IN THE DISTRIBUTION OF BONDS.

INTRODUCTORY.

When we consider the work of the Investment Banker and his importance and then think of the scanty material written about him, we are prone to wonder. I noticed it during my reading on bonds, and although I am sure that I have made a thorough search, I could find no connected work on the Investment Banker. In fact, the whole subject of bonds seems sadly neglected. There are only two first class books on bonds and investment principles, Lownhampts "Investment Bonds" and Lawrence Chamberlains, "The principles of Bond Investment". In 1908 the "Annals of the American Academy of Political and Social Science" devoted a volume to bonds and their features but they were unconnected, written by different authors and seemed to have different degrees of excellence. Many of our best magazines have investment pages and articles, but they do not cover the whole subject so that a reader can get a connected idea of the situation.

The investor, who wants to make a study of the principles, methods and work of the Investment banker, would have to go outside of the written material that we now have, in order to get a full and correct idea of it. And it is for the investor that I am writing this paper. Not for the regular big investor, who probably knows a great deal more than I can tell him, but for the investor who buys occasionally, or who wants to invest in bonds and who has had little or no experience with bonds, and bond houses. If I can ex-

plain this system to him, so that he can understand it, I am satisfied. If I can give him some light on the steps by which he gets a bond of the Pennsylvania Railroad, I feel that I am doing him a real service.

A practical bond man might question my ability to write on this subject. I am not setting forth any new and original ideas of my own but rather am combining the things that I have learned through extensive reading, acquaintance with bond men, and a deep interest in the subject. I believe my sources of information to be trustworthy. I am indebted to Roger Babson, Frederick Lownhampt, Lawrence Chamberlain, Moody's Magazine, The Chronicle World's Work, The New York Post and many others.

I do not intend to discuss the technical features of bonds, such as their classification, legal aspects and such things. The investor can read upon these things in any number of books. I only want to describe the many principles and steps in their distribution, hoping that I make them clear to the many, who I am sure, have a rather hazy idea of the subject.

CHAPTER II.

EVOLUTION, IMPORTANCE & A GENERAL VIEW
OF THE BOND BUSINESS.

That part of the public, which does not buy bonds, has little idea of the importance and value of the bond business to the economic life of this country. Our government has to depend on bonds for the money she borrows, our states use them to finance state projects, and our municipalities to further public works and buildings. They are the basis of our railroads, and of our public service corporations and our industrial corporations use them to a great extent.

Without the help of our bond house, we could not finance these enterprises upon equally favorable terms. The success of our bond house in passing through panics while stock exchange houses have fallen by the score is strong proof, that bond investment rests on principles, which can be made into a science. No bond house has ever failed except by violation of well known investment principles or fraud, and no business in the country rests on a higher plane of business ethics. The primary function of a bond house is to get capital, through its chief function, the selling of bonds. They have established themselves in public confidence in such a way that they can bring the investor and corporation together in the cheapest possible way, and they have extended credit and exercised a governing hand upon all enterprise. They are furnishing capital for the most worthy, and are turning the American people into a nation of investors.

It is impossible to tell exactly how many bonds are issued each year because there is no record of many issues, except in the house bringing them out. The amount differs with the year, but it is safe to say that over \$1,500,000,000. worth of new bonds is thrown on the market during the course of a year. Practically all of this amount passes through the hands of American bond houses, even the issues, whose ultimate market is the New York Stock Exchange, being first handled by the investment bankers. In fact the transactions on the exchange, which we hear so much about, are but a small part compared to those in direct merchandising. Where do all of those bonds go? It is estimated that one third is divided approximately equally between insurance companies, savings banks, trust companies and other banks. The other two thirds go to corporations for reserve and to private investors in this country and in Europe. It is this two thirds going into the strong boxes of the investor that I am chiefly interested in writing about.

The majority of people in this country will be appalled at these figures, and will not believe that the people can absorb such an immense amount each year. But the public could take many times that amount, if they were only interested in and understood the bond business. Think of the ten million savings bank depositors in the country, who could absorb billions of bonds if they were taught too, to say nothing of depositors in national and private banks. We are young yet, and in times of crisis are forced to call upon Europe to set us on our feet and take our stranded issues. But the investor in this country

if educated will willingly take all good issues offered and stand on a par with the French investor, who is always looking for more home bonds.

But you might well ask, if the business is so important and such a volume of transactions in bonds take place, why do we not hear more about it? Men engaged in selling bonds are quick to say that the man with a little idle money knows far more about stocks, or thinks he does, than he does about bonds. He understands the stock exchange and stock speculation far better than the principles of bond investment. Volumes have been written on the stock exchange. This can be easily explained by the fact that the element of chance and speculation is far more attractive than the comparatively dull investment in bonds. Writers and journalists realizing this, have entered to the majority, and we see the financial pages filled with gossip of stocks, dividends, melon-cutting and the dealings on the stock exchange. But this has changed. The experience of people on the stock exchange in 1907 has taught them a lesson, and it is no longer the popular and powerful place that it once was. The advantages of bonds are beginning to appeal to the public, and consequently we see more times and space devoted to them.

Relatively speaking the number of people conversant with bonds is small throughout the country, but I want to make an exception of the Eastern States where the number of people on the lists of bond house illustrate the prevalence of bond buying. It is the North-eastern States that take a large part of our issues, but the business is spreading west and we find the number of bond buyers in Illinois, Wisconsin and the Middle

States increasing rapidly and beginning to take their share of issues. Chicago is rapidly becoming a bond center like New York and Boston.

The bond business is becoming a science, and is accordingly becoming standardized. This is shown by the success of bond houses, and their methods of buying and selling. They maintain legal and engineering forces and make buying a science. It is too bad that the selling of bonds has not reached this state, but it is due to the ignorance of the investor, and to the obvious difficulty of getting salesmen who understand bonds. But there must be science in a firm selling millions of bonds a year to a list of 200,000 names, 195,000 of which have incomes of less than \$25,000. per annum. But this has not always been so, and the men who have been foremost in developing the business are still alive.

The leading banking houses have not always been primarily bond houses. Thirty years ago the financial business was transacted almost entirely by bankers and brokers. Bond selling and buying was incidental to the general banking, exchange and brokerage routine and was all done over the counter. The dealer took no responsibility and had no reputation built up by years of honest dealing. It was the man of wealth, and not the small investor, who was buying bonds then. In the days of Commodore Vanderbilt, the elder Gould, Fisk and Drew, the principle was "Let the buyer beware. Twenty years ago the best railroad and municipal bonds paid only 3%, and the public was eager to get them, although it was not nearly so large as it is to day.

Capital was cheap and the underwriting house got rid of their
(1)
issues easily, and there were no hair-splitting commissions and
arrangements as there are to-day, when it is often a long journey
between the placement with a bond house and the final taking by
investors.

But there has been a perfectly natural and logical
change in the business. In the few years following 1888 the era
of railroad reorganization took place and vast amount of new
bonds were put out, some of course in exchange for old ones. After
this had passed better times for bonds came and bond finance got
its real start. The public utility movement began at about the
same time and so we can see then the year 1900 fostered the
development of the bond business, in every way. In fact, few
large houses can claim an activity of more than ten or twelve
years. The tremendous development of bond financing that has
made two billions in one year possible implies tremendous buying
power and a great selling force.

It is the competition for capital that has brought the
business up. In those days capitalists and institutions took
big blocks of bonds, but these means have been supplied and ex-
hausted and the business is now with the army of investors, people
of moderate means, who sprang up with the increase of wealth in
this country. The small investor, who has taken two thirds of
our bonds in the last five years, is the one that counts; the
man who buys five or ten bonds and puts them in his strong box.

We might well say that it has been a change from whole-
saling to retailing. It has been a perfectly natural change.

1. "Lownhampt"

The growing number of investors and the filling of demands by buyers has made the competition for capital very keen. Ten years ago I. P. Morgan, Speyer & Co., and Kuhn Loeb & Co. stood above. Now they are sheering the field with others and it seems as if the control of a large sum of money is the signal to embark in the business, as is shown by the actions of large New York banks. All sorts of bond dealers have sprung up, numerous retailers, brokers and commission houses, and all who see a chance, seem to be in the bond business. And yet it can hardly be said that the number of new starters has exceeded those in other lines as clothing, hardware and banking. More bonds have been put out than would sell at first hand, and it has resulted in the establishment of scores of houses, all boasting a different line and keenly employed in digging up capital.

Financial houses used to deal in both stocks and bonds but it is now a fact that the speculative business is done by members of the New York Stock Exchange and the investment business is done by "Bankers, Dealers in Investment Bonds". Of course an investment broker may have a seat on the Exchange, but it is usually understood that the firm specializes in one or the other of these two forms of enterprise. The financial atmosphere, temper and training necessary to good service in either have severed stock bond selling.

The bond business and its connections are sweeping everywhere, into small towns and into foreign countries. We can easily agree that it is important, and that a study of its strength and weakness will not be worthless.

CHAPTER III.

GENERAL PRINCIPLES OF BONDS.

There are innumerable classes of bonds, depending on the character of the obligor, the security, purpose or function of the issue, and the conditions attending the payment of the principal and interest. I will not attempt to give any description or definition of the different classes but will assume that the reader knows a first mortgage trust bond from a consolidated mortgage bond. Each class has its advantages of security, and other attributes. The most common and popular bond is the railroad bond, followed now, perhaps, by public utility bonds. Ten years ago the best houses did not deal in public utility bonds, but instead featured railroads. Now they are making their profit on public utility paper and are carrying the standard railroad bonds as advertisement. Municipals for a very large class and are carried by practically all houses as strict investments. Government bonds have their special spheres of usefulness, and industrials are popular with more speculative people.

Bonds are acknowledged to be the most popular general investment, and in studying the following elements of an ideal investment, we find reason for it. A bond seems to balance these elements in the best way possible, and the balance can be changed by taking a different class of the many varieties of bonds. The elements are as follows: (1) Security of principal which is the first and chief requirement of an investment; (2) Stability of income which makes a bond an investment; (3) Fair income return, which varies with the bond and with other elements;

(4) Market ability; (5) Value as collateral; (6) Tax Exemptions; (7) Exemption from care; (8) Acceptable durations; (9) Acceptable denomination; (10) Potential appreciation. The three qualities most sought after are security, income and market ability, and they really determine the price of the bond. Obviously they can not all occur in the same bond, because a bond with an active market for instance will have its price forced up by competitions for it, and hence the real rate would lower accordingly. Only in cases where the bond is without popularity, through prejudice or lack of knowledge, do we find safety and a very high return. And here can well be mentioned a phase of the investment bankers work. He can sell his clients, issues of bonds which have unimpeachable security, and yet an income considerably higher than would be the case were the issues known to the investing public at large.

A false opinion that many people have is that a listed bond is the only desirable one to hold. If we will examine the requirements of listing, we will find that it does not insure an absolutely safe bond as is the common idea. Practically the only advantage of a listed bond is its increased negotiability, but it is an accepted fact that this advantage is paid for by a lessened income due to its increased and wider market. The same can be said of guaranteed bonds which are guaranteed by trust companies. It costs to do this and while it makes the bond more secure it does not make it the most acceptable investment. If people could get the idea, that every advantage has its loss, they would make better and wiser investors.

There are other bonds besides the ones named, but they are not handled by the best investment bankers, except in rare cases. Timber bonds, irrigation bonds and many industrials have popular markets and are safe in many cases, but they can hardly be classed as investments.

There are many factors entering into the price and market of bonds, and I will endeavor to explain some of the more important ones. By the market of bonds, I also mean to explain the factors entering into their market ability.

The market is the demand for bonds. It may be an artificial market, as when a syndicate sells large blocks and buys them back with the other bond, in order to force the price. But as a rule the laws of cause and effect operate in the bond market with absolute precision and obvious effects. The banker, however, is the only one who can really understand and appreciate the causes. The distribution of the great mass of bonds is a comprehensive study of conditions which are often obscure. There are special conditions of a single issue and general conditions of the whole business as the decline in high grade securities in the last few years. There is no more important question in investment than to judge market conditions correctly. A man may be a good judge of value, and yet buy and sell wrong. He does not have to know all of the technical market conditions but only the general principles. New York City 3 1/2 's have fallen from 110 to 90 in the last few years without the slightest suspicion of safety. Their fall was due to the absorption of idle capital and the consequent rise in interest rates, brought

about by the unprecedented business activity of the country, and the unfavorable technical position of those bonds, due to an increased supply in the face of an increased demand.

Broadly the market movement of bonds are influenced by two things. The first is the loaning rate of money and the other is the general condition of business. Those two sometimes act in common and sometimes in opposition. A low rate will stimulate because banks are forced into the market in order to get a better rate. There is an automatic adjustment between the yield on free and invested capital. Good business advances the price of securities, because it indicates larger earnings and a stronger financial condition of the issuing concern. I could give many other conditions, as in panics, which have their effect on the investment market, but I do not want to dwell on the market. Bond houses do know these principles and govern their business accordingly, and by so doing, perform a valuable service to the investor.

One of the first things which a bond house considers is vogue. That is what style or class of bonds seem to be in popular demand. This vogue changes rapidly. For instance electric railway bonds may be exceedingly popular now, but owing to conditions may change suddenly and find a difficult market. Bond houses realizing this will favor such issues and try to specialize in them. Of course, vogue will tend to lower the rate of income, and it is a wise investor who buys a less popular bond, at the same time getting just as safe a bond paying a higher rate.

The size of the issue and its distribution are big factors. By distribution we mean the holding of it by many people and not having the issue concentrated in a few hands. The larger the issue and the more it is split up, the more ready market it will have because of its familiarity to a large number of people. And this results in a lower return.

Listing and guaranteeing have an effect on the market of a bond, listed bonds being as a rule the most marketable bonds.

The denomination is important in many issues as a small denomination will find a sale among the small investors. Bond houses are beginning to learn this lesson from Europe, and are recognizing the small investor by offering more and more issues of small denominations.

Even the name of a bond has a certain market value. The word mortgage or first mortgage seems to have a positive effect on the public.

The public likes a bond selling about par. That is they blindly believe that a bond selling at 101 and netting 3.75 is better than a bond selling at 90 and yielding 4%.

The rate of interest paid is of course the big thing in the market for bonds. Next to security of principal most people want as high an income as possible. Hence an issue of unquestionable bonds netting 3% will not sell well. The rate must correspond to the money rate, as illustrated before.

The seasons, by their influence on money, influence the bond market. Interest payments in January and July send the price up with the prospects of reinvestment.

Panics and depressions of course slump the bond market, making it exceedingly hard to dispose of holdings. Panics change the vogue and also the comparative prices of the highest grade bonds and the less secure one. It is a well known fact that the best bonds sell relatively higher during a depression than less secure ones. It is in free and easy times that the high income bond is popular.

Underlying all is confidence in business, high finance and enterprise. If people think that corporations and business are to be trusted, it goes a long way in the market. For instance in 1903 confidence was disturbed, and the bottom dropped out of the market. Political campaigns, talk of war and legal proceedings against a corporation all do their little part to disturb the market. Bond houses of course being in touch with conditions and sentiment in general are careful about what they offer. We often see them putting out short term notes for corporations in order to tide over depressions until a favorable market presents itself for long term paper. Bond houses stock up at low prices and because of their great money power can hold until prices go up. The houses of our country are so well informed and so closely related that we hardly ever see two parallel issues coming out at one time. That is large and important issue, which would be fatal to each other. Their business is to create as large a demand as possible but not to over-tax our buying and absorbing power.

The territory in which a bond is offered and in which it is issued affect its price. For instance it is impossible to

sell a municipal in some of the farming sections in the West. And investors often fell bound by sentiment and patriotism to take a bond, as the investors around Baltimore and Richmond did when they subscribed to the "Atlantic Coast Seaboard Line" bonds and lost fortunes. People like first hand knowledge too, and these preferences are not ignored by bond houses.

The legality of an issue for a savings bank or an insurance company is a big help to their market. Houses turn special attention to these institutions when they have such a bond, and this element of course adds to the price of the bond. Lots of investors feel that the only way that they can be safe is to buy such bonds and hence widen the market for them.

Tax exemption is a big thing and we see the statement "tax-exemption" wherever it can be put in. Taxes cut down the income and are always closely watched in the marketing of bonds. Some houses watch this and make provision for paying the taxes themselves, thus saving the investor the trouble.

The duration of a bond is important for as a rule investors do not want bonds of too long duration, or bonds that are liable to be called at any time. Advantages such as convertability into stock help the sale of a bond.

Public opinion as shown through newspapers and magazines affects the price. If there is a lot of talk about an issue in the papers it becomes better known and easier to sell. The ticker by the information it spreads may make an increased market for an issue.

The fact, that an issue is regarded favorably by for-

eign investors and houses, will often force the issue up or make a success out of a rather doubtful situation, as was the case with an issue of Pennsylvania bonds, participated in by Rothschild of London. Americans seem to think that foreigners buy only the best and safest, and blindly follow their lead. As a matter of fact foreign investors have suffered most heavily in our defaults. If the truth were known, the public follows many such a tip. And the power of some of our bankers often gets favorable comment in the papers as in the case of the famous Japanese loan. This was not proven but the suspicion is strang. The papers on the day of subscription told of peace movements between Russia and Japan, which were officially denied the next day after the issue was disposed of. The public likes to follow tips and be fooled, and probably always will but it can be truthfully said that our best houses do very little of this.

The standing and age of a concern and the price of a corporations stocks, have a marked effect on the sale of its bonds as does the class of people who seem to be buying the paper.

In short we may say that the conditions affecting the market and price of bonds are very complex and numerous. Understanding them is indeed the science of bond investment.

Now we come to the competitive forms of investments which widen the channels for money and hence restrict the market and price of bonds to a great extent. The chief competitor is, of course, the mortgage, which is unquestionably a good investment under certain conditions, and has always been popular. They pay a higher rate, are safe but are not so convertible and do not possess the potential appreciation of bonds. They are becoming

more popular with institutions, and we see the holdings of insurance companies increasing each year. There are companies which buy them up and sell them much as bonds are handled, and they are a big factor in the market of bonds. A salesman told me that it was particularly true of a comparatively new country like Minnesota where mortgages are widely held and few bonds are sold except in the twin cities. However, Wisconsin, a neighboring state, where the farms are older and more of them are paid for, offers quite a field for bonds.

The best stocks are more or less parallel to bonds and compete with them as investments. Great activity in stocks hurts the bond market.

Real estate bonds, timber bonds and irrigation bonds are some of the newer forms and are beginning to compete with the older and more conservative bonds handled by our best bankers.

Savings banks and other banks and trust companies take a large portion of the nation's savings and by paying interest compete with bonds. This is especially true in the East where savings banks are prevalent. However, savings banks in turn buy large amounts of bonds.

In short any channel of investment offering a fair rate of interest and good security is bound to compete with and affect the market for bonds.

CHAPTER IV.

INVESTORS AND INSTITUTIONS AS BUYERS OF BONDS.

It is very hard to classify and describe the different people and institutions buying bonds for it is certain that no fast and set division can be made. It is fairly easy to classify institutions into banks, savings banks, trust companies and insurance companies, all of whom take about the same proportion of one third of the bonds issued every year. But among private investors there are estates, widows, idle fortunes, surplus of corporations and many other cases. Obviously the list is endless.

Institutions as a rule buy from about the same motive and desire and buy about the same kind of a bond, namely a safe conservative investment yielding on the average a rather lower rate of interest than the individual would care to receive. Consequently they buy some Government bonds, municipals and railroad bonds. However, the last few years have witnessed a change and institutions are paying more attention to, and are buying great quantities of public utility bonds. Reports show that their holdings of railroad bonds are falling off.

The purchases of insurance companies and savings banks are closely regulated in some states as New York and Massachusetts, while other states have no regulations. However, we find most of the regulations in states which have the most of our large institutions. The regulations apply to security, interest payments, etc. and really do make a security, passing their requirements pretty safe. So bankers having bonds fulfilling the

requirements go after institutions, and such issues invariably have the statement, "Legal for saving banks in New York" or a similar one in all advertisements and circulars.

Savings banks and insurance companies who keep their fund in bonds continuously, desire securities which are secure and sure to pay their interest, but they do not care so much for convertibility. They want strict investments to hold and keep. Banks and trust companies, buying usually as an outlet for idle funds, desire a more marketable security.

We see among these institutions a fairly even and parallel demand for certain well defined classes of bonds. Their buying is as a rule in the hands of men in close touch with the market, who know what they want, and who knows where they can get it the cheapest. So bond houses in selling to these institutions must put up a quick, good proposition. Advertising does not do much good with large institutions. They very likely, will buy at public subscriptions and in cases may be in the syndicate, thus getting better prices.

It is the private investor that has the different tastes, desires and needs for bonds, all of which the successful bond man must be quick to see, appreciate and supply. No generalizations can be made unless we take those of one writer who divides investors in three classes, (1) those dependent on income, (2) those not dependent on income and (3) business surplus. The first class will want perfect safety and as high a return as possible. They will want sure and regular interest payments. The second class will want a fair income convertibility and a prospect of appreciation in value. The third class wants safety, stability of price

and convertibility. But as a rule these classes overlap and the investor has a number of desires and needs all of which the bond house must find out and try to fill.

One generalization can be made of the private investor, and it is this. He is profoundly ignorant of bond principles and bond investment. He cannot read a prospectus or analyze a statement of earnings. He is really at the mercy of one whom he has any reason to trust. Of course, there are exceptions but it takes a lot more study than the average investor will give, in order to learn bonds. He invests as a side issue and not as a business.

One thing which is reducing bond selling to a science is the rapidly growing education of the investor and we must credit this first to the wider practice of buying bonds and secondly to newspapers, magazines and the works of bond houses through circulars, booklets and their salesmen. Many of our best periodicals contain articles on bonds and investment principles and the financial pages are beginning to give bonds their share of attention. The best bond houses are changing, from a mere card or statement, to argumentations on investment principles and are teaching through circulars, and investment pamphlets. Bonds are acquiring their just place in finance and naturally people are beginning to learn more about them. And the more they learn the better it is for the good honest houses.

Even now every day brings its list of swindled investors, widows and orphans who are snared by imitation banking houses with a high sounding line of talk. But the average investor is beginning to see that his interest is with a reputable house, and is

finding out who those houses are. We will in time reach the state of affairs in France. The investor with \$100. or \$1000. will have no fear and will take up any issue offered by a good house. I believe we are passing our speculative stage and will soon be a nation of intelligent investors who will take any issue that our financial world may need to place.

CHAPTER V.

WHOLESALE AND WHOLESALE.

A feature of our present system of distribution is the system of original underwriting and handling of our largest issue of bonds by a few institutions in this country. These houses are probably the best known and the most closely watched by our investing public and the financial world. Their money power is so great and their influence on the bond market is so strong that they deserve a little study. In fact it is said, and seems to have been proven, that any large issue, in order to be a success, has to have the support of one or more of these great underwriters.

They are not many in number, there being less than a dozen. Ten years ago there were three houses who stood alone in the field of initiating large movements of securities through their strong affiliations with moneyed institutions. These were J. P. Morgan & Co., Kuhn, Loeb & Co., and Speyer & Co. Now they share the field with at least three other wholesalers. The First National, The National City, and The Guaranty Trust Co., of New York City. The Guaranty Trust Co. is a Morgan institution and the First National is closely associated with him, thus showing Morgan's strength. The National City is identified with other large interests as the Standard Oil. The entrance of these three banks shows a distance development. Control of the money which used to be sufficient is now the occasion to enter into a profitable business. This has of course made competition more keen but no concessions are ever made which would hurt the

business. It does not seem as if any more institutions will enter the field in the near future unless there is a change in money interests.

It is hard to make an arbitrary division of the wholesalers because no house can have a monopoly. Money strength practically decides the matter and gives the largest the first slice of profits on a large issue. I have named the six largest, but firms like William Salomon & Co., Blair & Co., and J. & W. Seligman & Co., are known chiefly as underwriters or wholesalers and do a very large annual business. Many other houses as Harris Forbes & Co., N. W. Halsey & Co., Lee Higginson & Co., White Weed & Co., Spencer Frask & Co., Hallgartner & Co., William Read & Co. Kidder Peabody & Co., Redmond & Co. Clark, Dodge & Co. and others do a great amount of wholesaling and underwriting but do not originate the largest issues.

The prominent wholesale dealers confine themselves to our great railroad systems, whole issues of municipal and state bonds, and occasionally bring out a very large public utility issue. They also participate with foreign bankers in some of their issues and share the issues of foreign governments as Japan.

These largest houses are competitive in a way but are so closely related and informed that it seems to an outsider as if they were combined. They realize the danger of bringing out parallel issues and are careful not to do it. They also share many issues.

A feature of the system is their work as fiscal agents for our largest corporations. These corporations have not the machinery for putting out their securities and by forming affilia-

tions with a house, they get the experience and knowledge of that house and hence are afforded the best market possible at no trouble to them. The houses in the capacity of financial advisers to corporations have caused many strong affiliations to be drawn and we see distinct lines drawn. For instance, if New York Central is going to issue \$20,000,000. of bonds, all eyes turn to J. P. Morgan & Co. Needless to say these affiliations are a great source of strength to the houses themselves as the financing of a great railroad system is no small matter. Their real function is to furnish capital to these large corporations, and in many cases they are under contract to do all of their fiscal work.

They are houses of original underwriting and issue and do practically no retail work. They have no travelling salesmen, but sell by public subscription stimulated by extensive advertising. They leave the retail work to the houses and institutions which are invited into their various and numerous syndicates. This underwriting is more or less automatic. They simply guarantee the success of an issue to a corporation or rather in most cases advance them the money knowing that in a few days they will have the issue disposed of to syndicate members. They know that they can get rid of their issues because a regular member of their operations is almost forced to participate if he wants bonds in the future. Their profits vary a little but as a rule they never make over two points and seldom this much. One eighth of one per cent is profitable to them on a large issue. I will explain their syndicate methods more fully in the next chapter.

These bankers are also international in character. They lend their money strength and power to foreign houses and share in foreign issues getting the same service in return. Thus we see J. P. Morgan & Co. working with Rothschild in London. It is only fair to state that these inter-national bankers have not been trained by the necessities of personal relations between investor and financial agents, to accept and offer only such securities as they would be willing to buy for their own account. Our retail houses would not have their present hold if they had distributed blocks of bonds that have been distributed by American bankers in Europe. Mere magnitude in the operations of a house or of an issuing corporation does not give safety as financial history shows us. These international houses have their special sphere of usefulness but investors do not come in such direct relations with them and hence we will not study them so closely.

CHAPTER VI.

SYNDICATING AND UNDERWRITING.

The essential fact or reason for underwriting is to insure one or all against a great loss or failure by shifting or distributing the risk. Underwriting is insurance against an unsuccessful market. Of course there are a number of different plans of underwriting. The original plan was to guarantee the price of the issue and let the corporation itself do the work of selling. Another plan was to let the syndicate manager handle the selling and its details, and in case all were not sold, the syndicate members were pledged to take those left unsold at a certain price. The general practice now though is for the syndicate members to purchase the securities from the original banker or bankers.

The original banker, however, offers them to the public and if any are left the syndicate members retain them pro rata. Strictly speaking this last is not underwriting, but the term as now used or understood, means or indicates that a syndicate exists. The former plan was conditional and the latter absolute underwriting.

There are numerous advantages in underwriting. Bankers are experts in the valuation of securities and their judgement on the price and form of a new issue is valuable. Bankers are experts in selling securities and can get rid of them much more easily and to better advantage than the corporation with no facilities or the time for disposing of its paper. The corporation by selling out right to the bankers has no more responsibility and gets the

money immediately for its own operations.

Buyers of securities are benefitted by having them underwritten. They have the skill of a reputable banking house, they are sure that the whole issue has been sold by the corporation and that it has the money to go on with its work and insure its success and they also have the assistance of the house in helping the corporation out of difficulties, and in watching its methods. Of course, underwriting must be paid for but corporate financing is better and more efficient because of the value of supervision by financial experts.

Of course, all issues should not be underwritten. Very small issues can be sold to a few investors or to people interested in the concern. However, the experiences of the Pennsylvania Railroad in 1909 and the United States Steel in 1903 have convinced corporations that they cannot themselves dispose of issues, no matter how well they stand and are known. They both had to turn to underwriters before these issues were a success.

One would expect large financial houses engaged in underwriting to handle a good issue alone and that rivalry would prevent their co-operation. However, they have learned that there is always the risk of a bad market and that no matter how powerful they are that it is better not to take the chance of a severe loss or ruin. It is not considered conservative banking for one house or even two or three to underwrite a very large issue. Many houses refuse to underwrite over one or two million dollars of an issue, depending on the size of the house and business conditions. By this co-operation too, the bankers can

handle a greater range and variety for their clientele and thus, get more business. Syndicating gives a broader geographical distribution and no section of the country is overloaded with an issue. So we can see, I think, that underwriting and syndicating are almost necessary and are at last desirable on large issues.

I will not attempt to describe the buying of issue from corporations. It is done by experts whose knowledge and experience is the best possible. It is a science of statistics and facts.

There are many kinds of syndicates which work under many different methods or rules, and it is hard to describe them accurately because many are never brought to light. In many cases the syndicate members are not made public but they are usually known in the largest issues.

The members are usually bond houses, banks, trust companies, insurance companies and sometimes, individuals. They may be gotten in different ways. In most cases a banker before or when about to take over an issue confers with his chosen parties and offers them a chance or invites them to join which they seldom refuse to do without good cause. Then arrangements are made which may be only verbal, but which are usually made under a regular formal syndicate agreement. This agreement contains all the terms of the syndicate including prices, amounts, length of time and probably provides for an extension. The profits vary with conditions, as a misjudged market may mean a loss. A high profit on high grade securities is unusual. Each member now has his hands tied and must live up to the provisions in the contract. Each member has an allotment for which he has paid and he may

withdraw it from sale and keep it until after the syndicate is dissolved in the hope of a higher price or he may leave it with the syndicate manager to be disposed of by him taking what is left at the end. Syndicates are terminated by lapse of time or by the sale of all of the securities. If the member elects to keep his share he may keep it or if a bond house will turn it over to the regular selling channels.

The bonds left to be sold by the syndicate are turned over to one or two firms who are the syndicate managers and who usually are the same as the original underwriter. All negotiations, subscriptions and advertising are instituted by that house. The participating houses are allowed a commission on subscriptions secured or sales made. The syndicate manager gets a commission. Non-participating houses and brokers are also invited to send in applications and are allowed a commission on all subscriptions secured. The participants always keep in close touch with the manager and advise him on sales and methods to be used. Where one or two houses are acting together or where the syndicate managers have associates in the management the territory is usually divided, each firm getting certain states or cities.

The following steps are usually found in syndicate operations. The first is the preliminary private sales. For these attractive advertisements and circulars are prepared and all data is collaborated so that any information on the issue can be quickly given. In negotiating private sales members of the firm and heads of selling departments present the proposition to large investors and to institutions such as banks, trust companies and insurance companies, confining their efforts to

their most promising clients. The less promising and smaller investors are then solicited if necessary.

Next to private sales the simplest method is offering at a given price at a certain specified time for public subscription. Of course this is not done with municipal and state issues as they were originally gotten in this way. Public subscription works best with the issues of well known corporations whose issues are known and widely spread. The offering usually comes out two or three weeks before the date set for subscriptions. The main facts of the issue are given in advertisements with the statement that more details will be given on request. The investor will apply direct if their own house is offering or if not they usually apply through the house with which they deal. As soon as the issue is fully subscribed the books are closed. Sometimes there are so many requests that the opening of the books is a mere formality. Issues are often many times over, subscribed but the sellers always reserve the right to reject whom they please or cut down the amount given. They require a cash deposit with the offer.

If the total is not subscribed the remainder is taken by the members and treated as if it had never been publicly offered. Of course failure will hurt an issue. This brings us to the work of the retailer and his work of selling to private investors which I will take up in later chapters.

In syndicate selling every effort is made to keep the issue "off the street", that is from being offered by street brokers. To do this the syndicate managers have the privilege up to a certain price to buy back any bonds that may be on the market. This

is a legitimate method of protecting the market against any decline due to reselling.

Such re-selling may come in any number of ways. Speculators who have bought for a "turn" may be trying to get out, investors may find it necessary to liquidate or some may change their mind in regard to the bond or think that they see something better. After the syndicate is dissolved this cannot be kept up and the bonds may be traded in freely. Remnants may appear on the monthly circulars of a house for a long time. It is the selling of these remaining shares which each house does as it sees fit and also the re-selling in the open market that determines in a great measure the subsequent market course of the issue. To counterbalance these sales is the continual normal demand of new investors, additional purchases by those who wish to add to their original holdings, and the buying of houses not in the original syndicate who wish to accumulate a block of them. It is here that the street broker comes in, trying to fill various demands and watch reciprocal orders to buy or sell. It may be years before the issue is finally absorbed but it is the fate of every issue, no matter how large, to be finally taken from the market.

A feature that I have not touched in regard to syndicating is the participation of insurance companies and savings banks. They need huge blocks of securities and if they are in a syndicate they can get them at a lower price. This often done but it has been abused in some cases and it has been proven that such institutions were in collusion with large bond houses and took large blocks of unsuccessful issues thus ensuring profit to the house. They really acted as a depository for bonds thus giving the house

much greater power. Stringent legislation seems to be stopping this in most cases.

CHAPTER VII.

BOND EXCHANGES AND TRANSACTIONS.

It is perfectly possible and true that people holding bonds as investments often want to dispose of them, buy more of the same issue or some of a different issue. The investor is constantly changing his holdings but to no such extent as the holder of stock who through the desire for speculation and the relative uncertainty of the stock offers a wide and active market. Bonds are really of two classes, one regards exchanges and transactions, those dealt in on the Exchange and those which are not. Bonds are little dealt in for speculation as the profit is too small and the business is very uncertain and dangerous. Hence the transactions do not have to be made so quickly and the investor will willingly wait a week or longer for a bond that he particularly desires.

Transactions on the Exchange are much like those in stocks. There is a listed and an unlisted department. The listing of a bond requires certain information, but it does not necessarily make a more secure bond, but rather better known and more convertible one. It is said that only one twenty-fifth of our issues reach the exchange and that the average annual transaction amounts to only about 800,000 bonds a year, while often a million shares of stock are traded in a day. The amount of trading in securities which are recorded on the "Board" represents only a small part of the purchases and sales in the financial district. For instance government bonds are quoted, but 90% of these transactions take place in banks and with dealers in bonds.

The bonds in the listed department containing the majority of railroad bonds, government, state and many corporation bonds, do not fluctuate widely and take the form of the solidest investments. The unlisted bonds consist largely of industrials. Some corporation bonds, most public utility and state bonds and all municipal bonds are neither quoted or dealt in on the Exchange. The commission on transactions is $1/8$ of 1% on the par value and the records are furnished to the public through the tape and through the quotation sheet published every day and giving bid and asked prices and all transactions. The quotation prices are as a rule unreliable and may be due to manipulation. The actual market is usually below the quotation given. New York is the great and central market for our bonds and most large and active issues are on her exchange. Our large railroad issues are often listed abroad.

There is no doubt that listing would always be desirable if it did not cost, but except in an indirect way it adds no security. For the purpose of hypothecation, a fairly marketable bond will serve whether on the board or not. If an instantaneous market is demanded, choose an active listed bond, but be sure it is active for appearances are often deceiving.

But the market for ordinary investment purposes is outside of the exchange and the quotation sheet may be ignored. Listed bonds are not necessarily current and current bonds are not necessarily listed. And neither current or listed bonds are necessarily the most desirable investments considering the

added price.

The main market for bonds is through brokers, commission houses and bond houses or investment bankers.

There is a host of brokers of different sizes and classes throughout the country who understand the peculiarities of the market and who know where they can get a certain bond the cheapest and quickest. These brokers handle immense quantities of bonds filling orders for investors and making a small profit. They buy and sell on commission, needing only capital to clear. They buy orders already received, the purchaser paying for the bond when delivered and giving the broker a commission of $1/8$ of 1% or $1/16$ of 1% on large amounts. The business is very safe and profitable and many firms in New York as Vickers and Phelps, and Coffin & Co. do a very large business. They are usually members of the Exchange and can fill orders there. Sometimes they depend on banks to do their clearing and thus they simply buy and sell and do not have to bother borrowing if the purchaser cannot pay when they are delivered.

Some firms make a specialty of turning over highly inactive bonds in which there is a good profit. They maintain lists and often buy outright with no immediate prospect of a purchaser.

There is a class of brokers called bond arbitrageurs who go about the offices of larger brokers and investment houses ascertaining and filling their needs and who act essentially as brokers without ever purchasing a bond on their own account.

The largest and most efficient system of exchange is the net work of bond houses throughout the country. This system,

unlike that in any other country, reaches out with its branch offices and travelling representatives over the most of the United States and Canada. This system with the telegraph and telephone furnishes the legitimate functions of an investment exchange. There is no such system for stocks. The federation of houses handling uncurrent and unlisted as well as listed and active bonds, through an extended clientele and a highly developed street brokerage business puts the buyer and seller in quick communication. This system works so well that 90% of transactions in listed bonds are estimated to be outside of the exchange. If we examine the holdings of our big houses and notice the amounts of standard listed railroad bonds possessed by them, we will understand where the real market for listed bonds is. A house specializing in governments will do better for you than the exchange and if one wished to purchase Peoples Gas Light and Coke Co. Refunding 5's he would do better with a large Chicago bond house than on the New York Exchange, where they are listed.

People often think that houses make excessive profits on their exchanges and begrudge the profit when they can trade on the exchange for $1/8$ of 1%. But these house market securities which the exchange would never handle and they earn their commission. They do not make much on active listed stuff. The board often charges a point more for an issue than it can be gotten for on the street simply because the issue is partly left in the syndicate hands. Such securities will not seek their own level until they are out of the underwriters hands.

Investment houses take particular pains with the bonds which their clients want to sell especially if they are bonds which that house originally issued. Houses often guarantee to buy back at a certain price within a certain time if the investor wants to sell. This service of converting bonds is one of the many advantages of buying through good investment house. The house knows its lists and knows where it can buy or sell and perhaps make a profit or at least lose nothing by their assistance to their client.

CHAPTER VIII.

RETAIL BOND HOUSES.

I have described the main principles of bond investment staying as close to the investment banker as possible by discussing things concerning the relations of investor and bond house. But this has been only in a general sort of way and I want now to take up the main object of my work namely describing and discussing the work of the retail bond house in the distribution of bonds to investors.

I do not have any one house in mind but rather want to treat of the class of so called retail investment bankers whose function is the supplying of capital by means of selling bonds to investors with whom he has certain well defined relations. It is of these relations that I now want to treat.

Retail is not a term which properly describes these houses in mind although it suggests the relative sizes of same handled and the volume of business done. It misleads if it suggests that the main business of such houses is to distribute among small investors, issues that were originally investigated and purchased by whole-sale houses. This is not at all true because for the most part each of our American retail houses buys its issues independently in accordance with its investment policy or buys them in joint account with other houses having similar principles and policies. These houses are autonomous.⁽¹⁾ Their prosperity is built on their ability to find and obtain on the one hand funded obligations that merit investment and on the other hand Chamberlain.

other hand a clientele that has faith in them and in their business judgement and honesty.

These houses get their bonds in three ways. They either buy an issue directly, buy it in connection with associate houses or accept blocks from the large wholesale houses. Houses like Harris Forbes & Co., N. W. Halsey & Co., Lee Higginson & Co. and others do a large annual business both in underwriting and retailing. They maintain expert buying forces and it is through these houses that the largest part of municipal and public utility offerings are distributed. Their organization is developed with selling as the real function and they can handle the smaller as well as the larger issue of both municipal and corporation bonds.

Another small group of retail houses can be distinguished whose operations are chiefly confined to accepting syndicate offerings and the subsequent distribution to a clientele with or without a specially organized selling force. Some of them do as large an annual business as the houses named above, but as a rule their clientele numbers large investors and institutions. Some of these houses have as their main business the executing of orders on the exchange but who have more or less of a bond department and a number of regular clients.

These retail houses which have been mentioned and classified do the greatest and most important part of bond financing. They are the ones who dispose of \$1,000,000,000 of bonds a year and place them in the strong boxes of investors. They do this by many different methods and those methods I will try to discuss under their organization.

The existence of these houses has been rather short but they are beginning to work on well defined principles and each house is getting its own specialties. Some deal in bonds of a certain locality, others specialize in the municipal class and others in electric railway bonds. They are responsible too for the growing education of our investing public.

The general policies of these houses is honesty. They are building up clienteles and are doing it by honest and fair dealings. One writer says that there is only one house in New York and one in Boston lacking in integrity. That is among the class holding themselves out as investment bankers and dealing in such a class of bonds. And the houses seem to be living up to this rule of honesty, realizing that it pays in the long run in such a profession as they are in. Their present success is due to their honesty.

A thing to be deplored is the existence of swindling houses. These houses try to put up the appearance of conservative bankers, but sell worthless securities, working on the small uneducated investor. They issue attractive propositions and make many high sounding promises of high interest getting the money of people who think that is best to get a high interest not realizing that there is a vast difference in the security of bonds. They are difficult to prosecute and as a rule get the money of people who have not the money or knowledge to carry on legal proceedings. There are now houses on Wall Street that do this business and which are difficult for the uninitiated to pick out. But an investor by a little trouble can easily find out.

The good conservative house are gradually killing the swindling houses by spreading information although there are communities to-day who will almost shoot a bond man on sight. But this sentiment will be overcome and the honest house will have a much wider field.

The retail houses are in a profitable business although the competition is becoming keener every day. They get their profit by syndicate commissions, trading profit and where they buy an issue outright they of course make the difference between the selling and buying price. They do have large amounts of money tied up and often get caught in depressions with their shelves full. But the interest on these bonds held will pay interest charges and they understand fundamental conditions so well that it is seldom that they get caught in a helpless position.

CHAPTER IX.

THE ORGANIZATION OF A BOND HOUSE.

A bond house is the name used to denominate a partnership or corporation formed or organized to buy and sell evidence of municipal or corporation debt. All bond houses are banking houses in that they advance money to municipalities and corporations. However they do not as a rule do other banking business such as loans and deposits except as a convenience to clients. If they do a general banking business it is run entirely separate from the bond department as it does not bring the best results to mix the management of the two. So in this country the name bond house has come by custom to apply to those who attempt to sell by advertising, circulars and solicitation as distinguished from banks and brokerage houses which sell on commission only.

A bond house is usually divided into five departments, the importance of each depending on the specialty of the house. They are (1) The buying and statistical department, (2) The selling department, (3) Order department, (4) The financial and banking department (5) The book-keeping department.

The buying and statistical department studies new issues, employs engineers, expert accountants, appraisers, legal advisers and statisticians to compare different propositions offered. They have clerks to analyze reports, statements and mortgages and put everything together in a concise and logical form. The buying is a science and the success of a good house depends a lot on this buying for it is a axiom of the business that a bond

well bought is half sold.

The librarian has an elaborate system of files for the statistical side and collects and files all sorts of data on every corporation or issue in the United States. They also keep files of current news, reports and newspaper clippings which may apply to the bond business. There are other files for the syndicate agreements and assignments of the firm. These files are all supplementary to and independent of the regular files containing the correspondence, bills, receipts, vouchers and all records in their business transactions. The work of the statistical department is further divided into classifying, indexing and filing, and research and compilation.

In the library are books concerning the regulations of savings bank investments, trust companies, insurance companies, estates and trust funds. Reports are kept of all financial institutions who buy and need securities and of all banks and other institutions. The shelves also contain all sorts of reference books, manuals and financial papers and magazines.

Advertisements especially those describing securities are prepared by expert writers in this department. This department has all of the data on all subjects and can give it to other departments at any time thus saving energy and waste.

Much of the success of a bond house rests on the buying department and the statistical department. It is a business of statistics. For instance, the statistics kept of an old issue will give some idea on the probable success of a new issue. Clients rest much of their faith in a house which they

think has an expert and accurate buying department. The selling department cannot keep a bond from being defaulted.

The selling department has charge of all dealings with investors and clients of the house. This department is usually divided up among as many head salesmen as are necessary to care for the business and territory. They are high grade men and selling experts and are of ten members of the firm. Each one has his territory and his salesmen over which he has direct and final authority. He personally attends to important centers and investors and covers as much of the field as possible.

Some houses prefer representatives with residence in their own special locality while others prefer headquarters at the main office or nearest branch office. Many combine the two methods according to circumstances.

Most of our large houses have regularly equipped branch offices in the larger cities as in Chicago, New York, Boston, St. Louis and San Francisco and these offices form the center of operations for the surrounding territory. When they do not have branch offices they usually establish close and friendly relations with some similar house in the other localities. They have special wires and by reciprocal courtesies they obtain many of the advantages of branch offices.

In fact this system has advantages not found in the branch office. It allows additional enterprise and affiliation of the correspondent firms. And more over many branch offices do not pay but are kept more as advertisements. It is questionable whether the branch office is adapted to a strictly bond business.

Another plan which has been tried is the system of local dealers who represent different houses where one house can not support a man. The system is not unlike fire underwriting by local agents. But this plan does not work well because it is impossible to get local dealers who know bonds and who will give the different houses square treatment.

The selling department also reaches investors through banks and trust companies in smaller towns. These banks know the investors and have their confidence so that they can place their orders. The banks make a profit or a commission in this way. The practice is growing and yet it does away with the close relations of investor and the bond house which is one of the features of our system. Bond houses though do try to get the co-operation of banks who deal in bonds and they sell them great amounts of bonds. They often allow a local bank a commission on a sale if it is not in an active security.

The selling department execute all orders of clients and investors for the purchase and sales of miscellaneous bonds. In order to do this a record of all offerings and inquiries is kept with the idea of executing orders to the best advantage. The house also keeps a list of miscellaneous bonds which it has or can get. Brokers play an important part in these operations.

When an issue comes out for sale the sales department gets all of the information from the buying department on the issue and circulars are printed, giving a description of the bonds and the most attractive features of the proposition. These circulars are first given to the salesmen for their personal use

and there are conferences between the heads of the department and the salesmen on methods and manner of presenting the proposition. There are elaborate discussions of details and each salesman familiarizes himself with the bond so that he can answer all questions and put up a good talking proposition. Salesmen to be successful must understand the security that they are offering.

The principal point of contact between the house and the buyer of bonds is the travelling representative whose advice as representing and coming from the house is followed to a very material extent by the investors. Hence the men sent out are men of more than usual business ability and intelligence. A large number of the force of the best houses consists of college men, because they possess these qualities and are more acceptable to the people who buy bonds. These people are often college men and well educated and it takes such a man to impress them.

The salesmanagers often watch graduating classes and will employ men who put up a good appearance, address, can give good references and who show the earmarks of a salesman. Of course these men start in the office at the bottom where they receive a thorough training on all the phases of bond finance. The business is an honorable one and offers great opportunities for young men. It is said though and it is more or less true that it requires influence to get a start in the best houses. After a man has made good though he never need fear being out of a position. Rival houses are always on the lookout for men with a list of clients which they may bring with them from another house. And we often see successful salesmen starting

houses of their own as did two Chicago men in the last year.

A prominent manager of a well known house put that proposition up somewhat as follows. Salesmanship in a sense is a battle between two forces. One side is an army of bond houses, trust companies, bankers, brokers and promoters and the other side is the great mass of people having money to invest.

This army of investors is very much disturbed and they are attacked from every vantage point. A small per cent will accept terms received in letters from bond houses. Some are almost persuaded but turn a deaf ear and decide to keep their funds and continue the fight. Others are very much offended, determine to keep their money and will keep their money until the end especially if they have sometime suffered losses. Others have no idea what they want but will fight because their friends are in the

Here comes the representative of the bond house. He occupies neutral ground and must find out the troubles of the investors and tell them to his firm. His is a great position as he has the trust and confidence of both sides and must be true to both but his biggest trouble will be with the investor because he will not come half way. He will not tell what he wants or whether he wants anything. Here is the place for the salesman to demonstrate his ability and intelligence and convince the investor that he and his house can do him a great service. If he can do this he gets the confidence of the investor and his order.

Some people say that a salesman is born and not made but study will show that these so called born salesmen have made

their fame on one or two lucky sales. Men with backbone and ability are susceptible to instruction and are the most valuable in the long run. The salesman should build his foundation upon intelligence, appearance, persistence, self-control, and diplomacy. He must be honest and realize the dignity of the profession, be ever studious and know every happening in the financial world. He must be man enough to get the confidence of all and must protect the buyer remembering that he will be on the market in years to come. Salesmen have many pit falls, but the most common are, recommending from a speculative stand point, trying to predict the trend of affairs, talking too much and belittling other houses.

The salesmen are always kept in close touch with the house. They must communicate daily by report slips on persons seen and their interests, prospective business and local conditions. They also report any opinion on the securities offered, any general preferences and the investment situation as they see it. This is a big help to the house in issuing new securities and a list of these reports is carefully kept.

The salesman not only visits regular clients but is continually on the watch for new ones by watching growing fortunes and estates and soliciting them. The success of a salesman is measured to a great extent by new business gotten. A man getting new clients is a real producer.

In turn the house by daily letters circulars and telegrams keeps the salesman constantly informed on all subjects including new issues, prospects and general market conditions.

These general letters contain all news of the house and such information as would help the man. Most houses try to get the salesmen into the office every week where they can learn more than through the mail. In short a close system of advice and cooperation is maintained, probably closer than in any other field of selling.

So it can be easily seen how a good man operating in a fixed territory can win clients and by fair and honorable treatment of them becomes one of the most valuable assets that a house can have. He comes to know the investors, their likes and dislikes and he also forms local alliance with bankers and business men by which he can secure more friends and more business.

One of the features of the sales department and one of the main assets of most houses is the series of lists kept by them. All houses have some form of lists and the larger ones have lists of over 200,000 names, 175,000 of which have incomes of less than \$25,000. a year thus showing that the little investor counts. These lists could not be purchased for any amount of money as is proven by the fact that a well known house recently offered a reward of \$100,000. for the return of a comparatively short list. They are jealously kept from other houses and are gotten in a number of ways. Salesmen furnish many of them and they are also gotten from banks, tax lists and directories. They also include the names of all investing institutions and their officers. But the largest part consists of the names of people who by reason of idle money may wish to invest at any time.

There are different kinds and classes of lists. One may be of wealthy investors, another of regular buyers or one of

occasional buyers. They are also arranged by localities and preferences as to the kinds of bonds they will buy. Then there are lists as to legal regulations concerning issues which institutions may buy. This listing is elaborate and so systematized that the house by consulting these lists can utilize its selling force to the best advantage with as little misdirected effort as possible. A letter recommending public utility bonds to a savings bank when the bond is illegal for their investments would indeed be a waste.

The sales department has charge of all of the advertising circular letters, correspondence, circulars and booklets that are gotten out by the house and this work is a big item in the selling end.

Until recently there were only two kinds of advertising that a conservative bond house might do. The first was to insert a card with the firm name and their different functions in business. The second was to print a broadside offering of an issue of bonds giving all of its good points but all stated in a letter supposedly coming from the issuing corporation. Both of these were useful and profitable although the latter did not seem to get its share of business.

The more recent form though which can be well understood by reading our financial literature is now being widely used by all houses. This form discusses all sides of the investment in question and gives the essential requirements trying to show that the issue or all issues put out by the house will fulfill these requirements in the best possible way. Or another

common way is not to name any certain issue but to simply print certain investment information and principles, holding them up as the best ones and the ones followed by the house. They are argumentative in every way. This form of advertisement as practiced in our papers and periodicals is a great step because it shows bondhouses in their admirable advisory capacity. They are educating the investor in this way and thus strengthening their position.

Of course these advertisements are expensive and hard to write without tiresome repetition but they are worth the time of experts and seem to be paying best. They must be well written in a conservative way. They should at least give the reader the idea that the house has a sense of responsibility and advisory duty toward investors and that they are not afraid to openly state their practices and principles.

Of course houses regulate their advertisements according to the financial conditions, not advertising heavily in dull times and using the proper papers to reach the class of investors which they are interested in. If they think banks will be interested they advertise in banking matters.

All houses issue regular circulars which they send broadcast to their lists. They are briefly and carefully written and contain offerings with a brief description of them such as the security, amount, the company guaranteeing them, the rate of interest, the engineers and all vital statistics. These circulars are usually sent out monthly and contain descriptions of a number of issues. Special circulars are often sent out describ-

ing in detail some large issue. These circulars are sent out according to different plans. Some regular clients receive all circulars which in a large house number several a week. A less regular investor or prospective one might get only the monthly offerings, or might get them only on request.

The advertisements of the house usually invite applications for more detailed information on an issue and then the investor will receive the special circular for the issue.

The circulars are neatly printed and of course they cost the house a large sum of money for mailing them. The expense seems justified as they are the only means of reaching a large number of the list of a house.

Less recent in origin and of great popularity at the present time is the special investment pamphlet or booklet containing investment truths and advice. They are sent out under many forms or titles and are often very detailed and elaborate. But their main theme is to advise the investor on fundamental principles and show him why he should form affiliations with a reputable bond house. These of course are expensive and hard to write but they are one of the biggest steps toward the education of the investor.

Then the house has a chance to advertise and solicit by means of correspondence. They send out circular letters calling attention to some issue and advising the investor to purchase. These circular letters are most often used with regular buyers and are written in a way that would make a person feel that he was being especially favored by being informed of the issue.

The sales department contains a staff of expert correspondents who can write well and convincingly and who attend to all personal correspondence with the investor. It is a fact that very little of this personal correspondence originates with the investor although that which does is given every possible attention. But it is usually a confirmation in a letter of some offer made by a salesman thus giving the investor a rather important feeling. These confirmations are excuses for a more direct and personal presentation of the merits of an issue.

This correspondence is always well written in a business like way and on the best of paper. The house usually takes the position of an interested and dutiful advisor. It is said that one way to test a house is to send a letter saying that you are a widow with \$50,000. and ask for some advice. The good house will answer your letter and a less conservative one will have a salesman at your door immediately.

In short the selling department tries to pull every possible string in its advertising. They use many means all suited to some special end and they are not afraid to waste a stamp and a good letter in soliciting business. I am not describing any definite circulars or literature. It is very much alike in all houses and a letter will bring it to you in a direct way. This advertising is a big thing in the success of a house and many houses sell largely by advertising. A visit to the correspondence and advertising section of a large bond house will open the eyes of anyone and convince him of its importance.

The selling department is a big item in the organization of a house. Its accurate judgment of the market, its efficiency in selling and its advice to and cooperation with the buying department are big things. Good management of the selling department determines the success and profit of the house to a large extent. The sales department certainly has the relations with investors, upon which so much depends, in its hands.

The order department receives and keeps a record of all orders which are received through salesmen and the mail. These orders are kept through the use of slips and an order book. When a purchase or sale is made a slip is sent to the order department. Clerks make records in the books while a memorandum is kept telling whether the order was executed on the exchange, filled in trading or was an original sale by the sales force. One day orders are kept in one book and standing orders in another. All sales are delivered on the following day unless otherwise specified.

The security book shows an inventory of every bond in the house and where and to whom it goes. Then there are supplementary books for the transfer of registered bonds. Whenever a purchase or sale is made a book draft is sent to the cashier who can tell by these how much money he will have to borrow, the necessity for collateral and other information in regard to finance.

The cashiers department or banking department takes charge of receiving and paying for issues purchased and delivering and accepting money for bonds sold. The cashier has charge

of all loans which is very important and which requires a shrewd man in times of depression. He must be ready at any time to report on the possibility or advisability of buying another issue. He has tellers and assistant tellers to assist him in keeping record books of loans, interest, collaterals and individual loans and deposits.

Deliveries of bonds are usually under his charge or directions and are made by registered mail, insured or sent by express. The cashier is the credit man also.

His department is really a responsible and important one. The possibility of raising money quickly may mean that the house can get an issue more cheaply than slower houses or that they can take a profitable issue when other houses cannot. Hence the cashier usually tries to get close banking connections and some houses have foreign relations so that they can borrow in a stringency and will not be lost. They can borrow in good times very easily and the interest on the bonds as collateral will pay the interest. In times of panic though a house especially if in a syndicate will have its hands tied and if they cannot borrow they must sell at a loss. The importance of this department can be easily seen when we estimate the profit made by borrowing \$1,000,000. at 3% instead of $3\frac{1}{2}\%$.

Along with bond selling has come the demand that the house keep a banking department for the safekeeping of funds of those who may wish to invest funds in the future and also to accommodate those who wish to purchase securities before they have the full amount to pay for them. From these two necessities

many of our houses have taken a step and have started a small loan and deposit business for their clients benefit. Properly and ordinarily it should be restricted to clients and not carried on as a general banking business for profit although it is a cheap source of funds and the reason for the success of the large New York banks in bond selling. Several large banks have sprung up in this way. This banking function is run in connection with the cashiers department and is simply an extension. If a general banking business is done though, it is usually run entirely separate from the bond side. An efficient combination of a bond and banking house is certainly profitable.

The book-keeping department is really a summary of all departments and all ledgers, blotters and books are kept there. It may have the telegraph, correspondence and advertising side too but it is usually left to each department to take care of its own end of these functions.

CHAPTER X.

THE RELATIONS OF HOUSE AND INVESTOR.

How is it that the investor, the man with free money, who is in absolute ignorance of the very title of some classes of bonds, unfamiliar with bond laws, bond history and bond practice is able to buy bonds and so finance our largest and most worthy projects? One would say that he would be foolish to invest \$10,000. in bonds which were said to be high class railroad bonds and were really a lien on a little subsidiary line. Of course, investors have been swindled but we see thousands and thousands eagerly buying countless bonds each year and getting good conservative investment too. And the demand is growing each year. We assume the popularity of bonds as investments and give credit for their absorption to bond houses.

But the bond house must stand for something and give the investor full value in return for his patronage. And it does. It is said that 75% of our investing public buys entirely on the advice of some house thus placing its welfare and safety in the hands of the house. We now want to examine some of the functions of the investment banker which enables him to take and keep this hold upon the investor. What does he do that is worth while and how does he do it?

Of course as mentioned before the primary function is to raise capital. It is an economic institution made necessary by our present method of finance. But it does more than to simply raise capital. It raises it in a safe and sane way from

people who are perfectly willing to have it go as such. It does it smoothly without harming any other business activity. But we will assume that capital could be raised in other ways. So we want to look at the advantages to an investor who buys from a reputable house compared to the situation of one who buys on the exchange, direct from a corporation or from a promoter. These latter methods may be safe in many cases and are cheaper but still there is the chance present that the security is worthless.

In the first place a bond house by its superior knowledge of bond principles and from its desire to serve its clients in the best way possible, can buy bonds which are secure and which will pay interest. They have an expert buying force which can look at so many things that the single investor would be powerless to cover. For instance municipal bonds bought through a house are sure to be legal and one may rest reasonably assured that public utility bonds postured by a conservative house have the necessary security. But even bonds which are as scientifically purchased as man can do it present problems which the bond house can help best to solve. There are other things beside good buying.

However much we discuss the different functions of a bond house, they all exist because of and are tributary to the selling function because the house is in the business to make a profit through selling. Consequently we find the energy, attention, money and men all concentrated in the vital force of selling. The bond house is a merchant as much as a department store and so we would expect to find well established selling principles which would assure definite and reasonable profits but we

do not. There is not the science in selling that there is in buying. People may say that salesmanship is an art but this does not excuse misdirected advertising and the excessive cost of representation by men who are often incompetent. This cost of selling securities is its greatest evil. It is not lessening as is the cost of distribution in mercantile lives. We see new houses springing up continually, increasing competition and costs and yet we see no tendency toward lessening costs and toward consolidation.

Some houses make as much as fifteen points on an issue but this profit is not excessive when we consider the cost of selling. The average investor does not realize the cost of putting an new issue out with its printing and sending of circulars, its advertisements and the heavy expense of traveling representatives. The houses seem to have no exact scientific plan but go on a sort of hit and miss basis with the house who has the sharpest selling instincts winning. They are all realizing their position and are beginning to pay more attention to new methods.

Bond houses are gradually assuming a responsible place as advisors and directors of investment. They are becoming established and now many of our better houses can rest assured that their friends among investors and institutions will take a certain amount of any issue which they may recommend. Critically the advice of a bond house is excellent but technically it is often doubtful because they are as yet merchants rather than counselors. It is hard to be fair in the selling of two securities carrying unequal profits. But houses are beginning to express

investment principles through advertisements and printed matter and to give advice independently of selling. If this is honestly kept up it is plain to see that they will eventually come into the position of the great banks of Germany and France who can place any issue that they want to. This advisory function can only become sound and safe when the house recognize the responsibility of their position and guide their movements and activities in a purely scientific and professional way. Your questions will be correctly answered even now but there is always the desire to sell and it is the things that they do not tell that count. When they begin telling you the unfavorable point of an issue you can be sure that they have reached their proper status. One writer compares them to a physician saying that when they quit giving poor medicine because it is cheapest they will have reached their proper end.

At present from the investors standpoint is far from what it should be. In the first place the bond-man does not realize and understand the needs of the investor. He cannot read the investors mind and tell what kind of a bond he wants. He takes the stand that the investor desires a bond and that a bond which he believes good will satisfy the investor. If he can educate the investor so that the investor can tell him what he wants, it will be a big thing. You may want security in redemption or safety in market ability. If you will need a quick market you will pay more attention to the latter. For instance you can sell \$100,000. of Pennsylvania Convertible 3½'s in a hurry at a less loss than Norfolk and Western Con-

solidated 4's. If you had three months you could sell the latter. The investor does not want to buy market ability when he does not need it. Insurance companies, banks and such institutions study the situation and get bonds which will exactly serve their purpose and not paying for advantages which they will not use. Instead of buying a random bond from a random house he should inquire in his own behalf and be able to set the machinery of a reputable house to work in the right direction.

The protective function of a good bond house is exercised in two ways. One is the buying back of bonds which the client is forced to sell quickly in order to get ready money. Many of the bonds which are sold by good houses are of comparatively small issues and do not have a wide and ready market. And here we find another reason for the existence of the bond house. It can furnish bonds which are just as safe and pay a better rate of interest than those actively dealt in on the exchange. It is estimated that they average over one half to one per cent more. Now if the client did not have the house to fall back on, he might be forced to sell in an unfriendly market and may be take a loss of fifteen points. The house having sold him the bond and feeling a moral responsibility toward him will pay him all that it possibly can. They know that he may wish to reinvest those same funds in the future.

They can afford to pay him more for the issue because they originally sold it, and can sell more of it. A bond house will think twice before it will quote a price much below the original price which they received from the investor. This

function is a perfectly natural one and it is gaining prominence. Of course many houses differ in their attitude. Some take the stand that a bond sold is a bond sold. But the greater number will provide some method. Some only exercise this function on certain issues but guarantee to buy the bond back at two points less within a certain limit of time, say one year. As a rule though the best houses make no definite promises but simply say that they will keep the issues as active as possible and that they will try to buy back the bonds at a fair market price, whenever the investor needs to sell. We often see this statement made in advertisements by our first class houses. They cannot or do not pretend to do this in times of panic when it would be impossible to get enough money to satisfy everybody. They do not attempt to make good on issues which were originally put out by some other house and sold by them, except as a matter of policy. And they certainly pay no attention to the liquidation of bonds which they originally investigated but which were sold the investor by some other house. We often see houses dealing in securities on the street or among the other houses which they would not offer to their clients.

The bond houses are still keeping up this policy of liquidation even in the face of the falling market of the last few years. A good illustration taken from Moody's Magazine is this one. I have more confidence that New York City 4½'s of 1956 will be paid at maturity than the Blank Electric Company first mortgage 4's of 1949. Yet in five years I have greater confidence that B. J. & R. will pay me within two points of the cost of the electric bonds than that the open market will pay me

within two points of the city bonds. Thus B. J. & R. are strengthening to security in liquidation apart from the security in redemption.

The other protective function is exercised in an entirely different way. It is possible and probable that out of the numerous issues put out by our houses, that the value of some should become impaired and endangered by default of interests, failure or bankruptcy of the corporation, on a reorganization. In such a case the individual investor without power or money would be left without any recourse and would incur a severe loss which in many cases he would be unable to meet. The bond house by fostering an issue has a responsibility for its success. They do not guarantee such protection but in their statements simply recommend them and say that their figures and estimates are as near accurate as they can make them. Thus they would not have to perform this function but they are trying to get an honest and reputable standing, realizing that honesty is the best policy. And many of them boast with truth that no client has ever lost a dollar through non-payment of principal or interest. In order to do this they often pay interest on railroad bonds during a period with no earnings. And we always find them at the head of bond holders protective committees as in the Wabash Refunding and extension 4's. They watch the issuing corporations and in many cases have loaned them money at a crisis in their history and they are always giving advice which will prevent disaster.

There are houses that have paid little profit for years because they have voluntarily assumed losses for which they were not legally responsible. The most notable instance of this was

in the case of where a group of bankers handled the bonds of a hydro-electric company. A flood destroyed the site and the bonds were worthless but the houses rebuilt the plant and took junior securities in payment. It will be years before they will get their money back.

In just such ways are our bankers building reputations for honesty and integrity. This protective function should not be ignored by any investor whether he want security in redemption or in liquidation.

CHAPTER XI.

THE FOREIGN MARKET.

We like to think of New York as the financial center and it takes a panic like the one in 1907 to convince us that England, France and Germany are still the investing nations of the world. Nothing could convince us more of this than the fact that success of the American bond market turned upon the success or failure of negotiations to sell \$100,000,000. of railroads bonds in Paris. In the first four months of 1910 England took 107 millions of our securities.

Not over one in twenty five of our own investors own anything outside of the United States and then it is foreign government issues. Even the large issue of Japanese bonds were never widely distributed. It is probable that we will depend on Europe for capital for the next fifty years.

It is true that in the past the burden of our defaults has fallen most heavily on England and Holland and that Europe has set us on our feet many times. But henceforth this will not be. At our present pace we will probably be forced to absorb all but a small part of our corporate indebtedness. Europe is turning to newer countries. But even now the banker can still sell to Europe by doing it in a sane and scientific way. Europe has outgrown her industrial needs and she turns to outside sources. If the American banker will only observe correct investment principles, he can find an unlimited market.

The foreign movement began when we were trying to dis-

pose of our government bonds after the Civil war. Holland came first followed by England in the late seventies. From 1880-90 the English bought three billions of our securities and controlled three fifths of our railroads. France is a new field and offers great possibilities. We find different methods of sale, prejudice, desire for interest, taxes, etc., in the different countries.

Insurance companies in England are large buyers of our bonds and get them through London branches of our houses or through branches of their insurance companies in this country. Banks buy large amounts when the market is favorable and the vaults of most English banks contain a fair amount of our best railroad bonds. England gets these bonds in a number of ways. The chief method is for their large houses like Rothschild to come in with our international bankers as Kuhn, Loeb & Co. and take a portion of all of our large issues. Our large houses also have branches in England and they sell many bonds in this way. The broker in England has a well established place with investors and his help must be gotten. Then there are companies in England which purchase our bonds and issue their debentures against them.

The English market is pretty well covered and they will take nothing but a high class bond. They buy for investment and not for speculation and will hold until maturity.

Our houses are recognizing the fact that the future market is on the Continent and they are sending more representatives and establishing more branch offices every year hoping to get in with the national banking firms and with the investors.

Our large wide-awake firms have agents in all the large cities of Holland, Germany, Switzerland and France.

In Holland bonds are chiefly bought in large amounts by offices of administration who take the funds of the little investors and invests them for him crediting his account with all interest and charging a commission of one fourth to one per cent. Holland has immense amounts of capital among her small investors and they seem to prefer our bonds.

In Germany the great banks control the situation. The American Bank in Berlin was formed to help place American issues with the home banks. Germany favors her own issues. Ours are too complicated for her but nevertheless she is taking a share in our large underwritings.

Switzerland presents much the same problems as Germany, demanding a good yield and the sanction of the home banks. Our banks in Switzerland handles seventy five per cent of our bonds and subscribes to our best underwriting.

The French market presents the greatest possibilities with its thousands of small investors. Every one buys bonds in France but the American dealer must study the desires of the French investor and try to fill his needs. The big banks have the confidence of the small investor. It is expensive to list an issue in France and the tax is very high on foreign issue.

As one can readily see it is impossible for our banks to get intimate relations with the foreign investor and sell as we sell here. We must work through foreign branches and with foreign banks because they are the only means of getting the confidence of the investor. Our retail houses do not sell in

Europe to a very great extent. It is practically all done through our international bankers who get affiliations with the great foreign underwriters.

Foreign sales have a political significance too. France and Russia would hardly go to war because they are so vitally connected through the security market. French investors hold great issues of Russian bonds.

CHAPTER XII.

THE FUTURE OF THE SITUATION.

We have studied the present situation and we are forced to admit that it has many evils and problems. But bond houses are certainly growing better every year. They are doing the investor more of a service and are getting more of a hold upon him. They are supplying capital and at the same time regulating and ehcking our finance, a service which few of us appreciate and which they are doing largely through their relations as fiscal agents. They are educating the public and making it less dependent on advice. I furthermore believe that there is no great cry against the honesty of our leading houses.

The big evil is the lack of scientific selling. They have no definite selling system, they employ salesmen who do not understand their subject and they are advertising at random. This lack of system along with the present method of selling is costing too much. And this cost is not lessening because new houses are starting and there is no tendency toward amalgamation. The amount of money spent in the selling of a \$1000. bond will open the eyes of most people.

Chamberlain believes that the next ten years will see the fall of a considerable number of Eastern houses where the crowding is worst. It will take only a panic or the failure of some of their issues to do it.

Many people wonder why houses do not consolidate. Other lines have done it with advantage. It is certain that a

combination of the agencies of selling would lessen the cost. One salesman could easily do the work of two. A house would have a greater variety of issues to offer and would have more power. But as yet there is no tendency. Perhaps it is for the same reason that colleges and physicians do not consolidate. A firm hates to sacrifice the reputation that it has gotten by years of honest dealing. Amalgamation would destroy the identity of the house and impair its claims upon clients. Individuality is a big thing in the selling of bonds.

A plan which would lessen costs is to sell through local dealers but the local dealer is not fitted to sell bonds and cannot work for two or more houses in an impartial way. This plan has been tried and found wanting.

Sales through bond departments of banks and trust companies in smaller cities has become very popular in recent years and has foreign precedent. But this plan relieves the house of all responsibility and trusteeship in the issue and also cuts down its profits.

There has been worked a plan which might work in the future in a wider field. This is the issuing of collateral trust bonds secured by miscellaneous issues of a certain class such as electric light bonds. This gives a distribution of risk and at the same time it costs no more or very little more to market a large collateral trust issue than it does to market one subsidiary issue. But it too relieves the house of all responsibility for the issue.

Industrial bonds are rapidly coming to the front and are taking a place in the investment field just as public utility

have.

A feature of bond selling will be the future importance of the small investor. Some houses claim that it does not pay to trifle with a \$100. or \$200. bond but they are changing their views. Some of our wide awake firms are making a success to day out of the little bond. It is certain that many people who have bank accounts of less than \$1000. would buy bonds if they were in acceptable denominations just as the investors in France do. And people with small fortunes can distribute their risk by buying a number of little bonds. And it does not cost very much to sell these little bonds. People will come after them. At present there are at lease forty issues of good conservative bonds in denominations of \$100. or \$200. which have been sponsored by the best houses in the country and the number of small issues is increasing rapidly. France shows evidence of the success of the small bond in finance.

Bond selling is an honorable business and one that a man need never be ashamed of as long as it is run as it is now. The investment banker is doing us a great service and is improving it.

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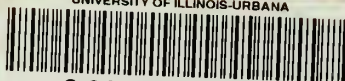
Modern Business Series.

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